FARM CREDIT IN A NORTHWESTERN STATE

In view of the ever-increasing demand for improved rural credit facilities, an analysis of conditions in a single state should be of interest. In a recent series of newspaper articles, the writer urged the farmers of North Dakota to organize some form of coöperative credit as a means of lowering the interest rate on borrowed capital.[1] Bankers immediately raised protests, declaring that rates were not too high; that seemingly high rates in certain localities were due to local conditions; and finally that these local conditions could not be eliminated by the inauguration of any new credit system. The controversy had not proceeded far when it became apparent that no agreement could be reached on the fundamental question of reform until two questions were answered: (1) What is the prevailing rate of interest? (2) To what extent is the rate affected by local conditions?

An investigation covering the above questions followed, the results of which are here set forth. The reader is asked to keep in mind the fact that North Dakota is a very young, agricultural state, which is still in the process of being settled. About 90 per cent of its population is rural; the density of population is only 8.2 per square mile as compared with 30.9 for the whole country. Only 45 per cent of its land area is improved.

Again, one must keep clearly in mind two types of loans, the long-time loan and the short-time loan. The former is for permanent investment purposes, such as buying new land, improving old land, erecting buildings, or purchasing expensive machinery. The short-time loan is used for purchasing inexpensive machinery, provisions, etc., and is used to tide the borrower over until the next harvest. The former loan averages about $1500 to $2500, and runs for about five years; the latter varies from $100 to $500, and runs anywhere from three months to one year. The long-time loan is secured by a farm mortgage; the short-time loan may be secured by chattel mortgage or it may be unsecured, and is always made on the farmer's personal note.

By means of questionnaires sent to bankers, implement dealers, and farmers, information was secured concerning both types of loans. Fortunately the data secured are sufficiently extensive to admit of reasonably safe conclusions for the entire state.

[1] These articles appeared in the *Grand Forks Herald,* Feb. 23, 25, 26, 1913; and in the *Fargo Forum,* Feb. 24, 26, 27, 1913.

Long-time loans. Questionnaires were mailed to 200 representative banks, of which 125 reported, giving returns for 45 out of the 50 counties in the state. As there are 660 banks in the state, returns were obtained from about one fifth of all the banking institutions. These replies show that the average farm mortgage runs for 4.94 years; and that the average interest rate is approximately 8 per cent (accurately 7.88 per cent). This 8 per cent does not include the expense of abstracting titles, examining the property, and the recording of the mortgage. These fees are invariably paid by the borrower. Nor does this interest rate of 8 per cent take account of the bonus that is frequently exacted, in the newer regions, from the borrower for the privilege of securing a loan; nor does it allow for the sum the borrower loses in paying his yearly interest in advance, which is deducted from the principal. In one county, for instance, a farmer had to pay a bonus of $50 for borrowing $1000 at 10 per cent interest. The farmer secured $850, since $100 was deducted as interest on the $1000 and $50 was deducted as a bonus. In this case the actual interest was considerably higher than the nominal interest rate of 10 per cent. While the practice of exacting a bonus is not common, it is generally the custom to deduct the entire year's interest in advance; assuming an 8 per cent rate, the farmer therefore pays $80 interest not on $1000 but on $920, which brings the rate up to 8.7 per cent.

While the average prevailing rate, according to our returns, is approximately 8 per cent, the rate varies in different parts of the state, depending upon the local conditions. In the following table is shown the rate of interest by groups of banks and groups of counties:

Table 1.—*Rate of interest on farm mortgages in North Dakota*

Number of banks	Number of counties	Rate of interest
15	4	6 to 7
45	16	7 to 8
36	12	8 to 9
13	5	9 to 10
16	8	10 to 11
125	45	7.88

The fifteen banks reporting less than 7 per cent rate are all located in the Red River Valley counties, *viz.*, Cass, Grand Forks, Traill, and Walsh. These are the most fertile and longest cultivated counties in the state. On the other hand, the banks report-

ing a rate of 9 per cent or more are located, as a general rule, in the newer and more undeveloped counties in the western part of the state. The counties in the central part of the state average from 7 to 9 per cent. The rates are lowest in the eastern tier of counties, and rise gradually towards the western part of the state, where the rate runs up to 10 and 12 per cent, which is also the rate in the eastern part of Montana.

That the 8 per cent rate is quite general for a large part of the state is evidenced from the fact that 25 of the 45 counties report an average rate of 8 per cent or more. In only 4 counties is the rate less than 7 per cent. One half of all the 125 reporting banks charge 8 per cent or more; and 110 charge 7 per cent or more. The following table shows the extent to which the several rates prevail in North Dakota:

Table 2.—*Interest rates on farm mortgages in North Dakota*

Rate of Interest	Population	Per cent of state	Number of farms	Per cent of state	Farm acreage	Per cent of state
Less than 7	113,518	19.7	9,376	12.6	3,879,222	13.6
7 to 8 . .	189,573	32.9	21,617	29.1	9,043,582	31.8
8 and over	273,965	47.5	43,367	58.3	15,503,846	54.5

It is clear from this table that at least one half of the state is subject to the 8 per cent rate, only a small part enjoys a rate below 7, and in no county does the average fall below 6 per cent.

The above figures are conservative. They are based on returns submitted by bankers who would naturally understate rather than overstate the rate of interest charged in their respective localities. Furthermore, we have a check on these bank returns in the replies received from farmers. Questionnaires were sent to over 100 representative farmers residing in different parts of the state; 29 farmers, living in 22 different counties, reported an average of 7.91 per cent on first farm mortgages, which rate is only slightly higher than the rate returned by the bankers in 45 counties. As a rule the rates reported by bankers and farmers are nearly identical in their respective counties. It is safe to conclude, therefore, that the average rate on farm mortgages for the entire state is about 8 per cent.

Short-time loans. Short-time loans are of two kinds, bank loans and book credit advanced by retail stores. The bank loan is made on the farmer's note, generally unsecured, though often

secured by a chattel mortgage. According to the reports received from 125 banks, the average length of time for these short-time loans is $8\frac{1}{2}$ months; and the average rate of interest is 10.75 per cent.

Table 3.—*Interest rates on short-time loans in North Dakota*

Number of banks	Number of counties	Rate of interest
2	1	7 to 8
9	3	8 to 9
13	4	9 to 10
38	13	10 to 11
27	11	11 to 12
36	13	12
125	45	10.25

The average rate on short-time loans, based on these bank reports, is 10.75 per cent. In the questionnaires mailed to the farmers, information was also asked for rates of interest paid by them on short-time loans, running from one month to one year. The average rate reported by these farmers, residing in 22 different counties, was 11.07 per cent.

An effort was made to compare rates paid by farmers with those paid by business men on short-time loans in the same locality. The same banks that reported an average of 10.75 per cent to farmers averaged only 9.18 per cent on loans made to merchants and manufacturers. Fully 95 out of the 125 reporting banks stated that the rate was higher for agricultural short-time loans than for commercial loans; 26 reported the rate to be the same for both classes; and only 4 reported a lower rate for the farmer. As North Dakota, however, is not a manufacturing nor a jobbing state, commercial paper is scarce, and consequently comparisons of the above nature are apt to be misleading. The significant fact remains that the farmer pays from 10 to 11 per cent on small loans, for short periods of time.

Store or book credit is a form of short-time loan which is perhaps more important than bank credit. In a state where the bank charges a high rate of interest, the farmer is more likely to buy merchandise on credit than to borrow from the bank and pay cash. The North Dakota farmer is rarely denied credit at a country store. To secure information on this form of credit, questionnaires were mailed to implement and hardware dealers, as well as to farmers. One question asked of implement dealers was: "What percentage of farmers pay cash in buying farm

machinery?" The answer from 54 firms, located in 35 counties, was that only 13 per cent of the farmers pay cash, 87 per cent buying on time. Out of 29 farmers reporting only 6 pay cash in buying machinery and supplies. These book accounts run anywhere from three months to two years: the average account is carried about one year (12.37 months). The farmer contemplates making payment immediately after his prospective crop is marketed. In case of crop failure the retailer will carry the account over until the next harvest season. A crop failure in a country where the farmer depends on a single crop, as he does in North Dakota, forces the retailer to carry the book account one whole year beyond the first harvest.

It is quite common for the dealer to obtain a note from the farmer,—the note generally bearing a 10 per cent interest rate from the date of issue. Often, however, the note does not begin to bear interest until the farmer has failed to make payment at the expected time, that is, immediately following the harvesting season. The 54 implement and hardware dealers reported an average of 10.26 per cent interest per year on these notes.

It was more difficult to secure uniform information from dealers on the subject of book credits, especially with reference to the interest rates charged on such accounts. The practice varies. Usually an interest rate is added to the credit price depending on the duration of the account. There is no common discount rate for cash purchases, though 7 per cent is most common, that is, 7 per cent of the credit price. This brings the credit price of a $160 binder down to $150 for cash. As a matter of fact all dealers quote two prices, the cash and the credit price, the difference between the two depending upon the reputation of the buyer, the shrewdness of the seller, and the degree of competition in the particular locality. Some dealers report a credit price of $155 for a $150 binder, whereas one dealer charges $180 for a $160 binder.

On this point, replies from farmers do not differ materially from the replies of the implement dealers. The difference between the cash price and the credit price of a binder is usually given as $5 to $10, and of a wagon or plow, as $3 to $5. The general discount rate is 7 per cent off the credit price. If the farmer borrowed $150 from the bank for four months at the current interest rate (10 per cent) and paid cash for the binder, the net cost would be $155, the interest charge being $5. But since some

dealers charge as high as $160, the interest rate on book credit is manifestly 20 per cent. In spite of this expensive book credit, farmers persist in buying on credit.

The implement dealers and the farmers are all agreed that cash payments would be preferable if rates on bank loans were reduced. The farmer, however, is often afraid to approach the banker for a loan. On the other hand, the farmer does not always see that the book credit is quite as expensive as bank credit, if not more so. The prevailing high bank rate, however, from 10 per cent to 12 per cent on short-time loans, does not encourage cash payments.

Are the foregoing rates too high as compared with rates in other communities? The "Crop Reporter" for April, 1913, shows interest rates on short-time loans in every state in the union.[2] In 1913, the North Dakota rate exceeds that of all other states; in 1912, it exceeded all but Oklahoma.

Farmers as a rule think that rates are fixed arbitrarily by the bankers and other money lenders in the community. That fundamental laws of supply and demand have any controlling influence is apt to be overlooked. Without attempting to justify the high rates let us state some of the conditions which help to explain them. The demand for capital in a growing state is always greater than can be met by the local supply. In 1890, North Dakota farms were mortgaged for $11,168,854; in 1910, for $47,841,587; in 1920 it will doubtless reach $150,000,000. Outside capital is attracted into the state by high rates of interest. Two life insurance companies, the Union Central of Cincinnati and the Northwestern Mutual of Milwaukee, loan heavily in the state. In 1910 the Union Central Life Insurance Company reported a total investment of $5,489,087.33 in North Dakota real estate. Local banks use farm mortgages in borrowing money from banks in large cities outside of the state. Every town and village has its moneylender who acts as agent for foreign investors in farm mortgages. Banks within the state compete for capital by offering high rates of interest on time deposits, and pay all the way from 4½ to 7 per cent interest on deposits. The rate on loans must necessarily be higher under these circumstances than where banks are paying 2½ and 3 per cent interest. The high interest rate paid on bank deposits is evidence of the lack of local capital to satisfy the local demand.

[2] *Crop Reporter* of the U. S. Department of Agriculture, vol. XV, no. 4, April 12, 1913. p. 27.

The inability to attract foreign capital on lower terms is due primarily to the character of the investment. The newness of the state, the instability of its population, the character of its agriculture, all make for uncertainty. Hence the speculative character of the farm mortgage as security for a loan. In the eastern counties where the land has long been under cultivation, where the population is more stable, and where mixed farming has in a large measure supplanted the bonanza wheat farm, rates are correspondingly lower than in the newer portions of the state. As the element of risk is eliminated from investments, interest rates will come down. At least this seems to be the consensus of opinion among bankers.

The character of the farming is frequently mentioned as a prominent factor in the credit situation. A crop failure under a single crop system, such as is practiced in North Dakota, is likely to find the farmer in bad straits. The payment of interest on the mortgage is delayed or deferred. The local bank or loan company is obliged either to carry the farmer along for a year or to foreclose. Since many farm mortgages are held by outside investors, the annoyance is sufficient to reflect itself in an increased rate of interest. Because of this fact many bankers are urging mixed farming as a means of reducing rates. This aspect of the question is well expressed in a communication from a banker in Stark County who says:

> It is our belief that the scarcity of money and the high interest rates are largely due to poor farming. The people having money to loan know well that our farmers here have a very uncertain income according to their present methods of farming, and would expect a much higher rate commensurate with the risk taken than when they can find people where money can be placed more safely. As conditions are here now, some people have not paid all of their interest for at least three or sometimes four years. In the older states, like Iowa for an example, where people farm well, interest rates are much lower. As soon as our farmers can show that they are safe and will take care of their obligations promptly, they can command the lowest interest rates that may exist. We believe it more necessary to work on better farming methods, encouraging them, than on better interest rates, for the lower interest rates are a natural consequence to better farming.

Another factor is the character of the population. One prominent banker says of North Dakota farmers: "They lack a sense of responsibility. Farm loans require constant care, hence high rates." Another complaint is: "Farmers are careless in not

making prompt payment or renewals of obligations." Some bankers think the high rates due to too much borrowing; that is, too much liberality in the loaning of money. Injudicious loaning leads to extravagance, and naturally calls for high rates to offset the risks involved. One banker in analyzing the situation claims that the legal restrictions placed on the loaning power of banks is responsible for undue high rates. In support of this view it might be stated that while the total farm mortgages in the state in 1910 reached the $50,000,000 mark, the power to loan on real estate by all banks, state and national, was less than $5,000,000. Banks are forced to loan on the personal note of the farmer, secured by a mortgage, instead of taking a direct mortgage on the property. Other banks turn these mortgage loans over to trust companies, and collect a commission from the farmer for placing the mortgage. At least one banker advocates the granting of more power to banks to loan on real estate directly, thus eliminating commissions and also removing the incentive to charge higher rates because of the indirect method of loaning on farm mortgages, as security for personal loans.

Commissions are responsible for at least from one to two per cent of the rate when loans are handled by real estate agents and loan companies. In the case of loans by life insurance companies, the state agent generally receives one per cent and the local agent, at interior points, receives one per cent. Two per cent could be saved by the farmer if the money could be borrowed directly from the investor, without the aid of an agent.

Allowing, however, for all these local conditions—the great demand for capital in a new and developing country, the inability to attract sufficient outside capital because of the risky character of investments, the irresponsible character of some elements in the population, the character of farming methods, the commission agent, and the legal restrictions handicapping banks—allowing for all these conditions, and because of some of them, it is believed that the farmers by organizing coöperative credit associations could reduce the rate of interest on both long and short-time loans; and, furthermore, that such coöperative credit facilities would be a means of improving the methods of farming, would encourage stability in population, and would make the farmer feel that he is not being discriminated against in the borrowing and employment of capital.

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